Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—Creator of Stoner Cats web series charged for unregistered offerings of NFTs, (Sep 14, 2023)

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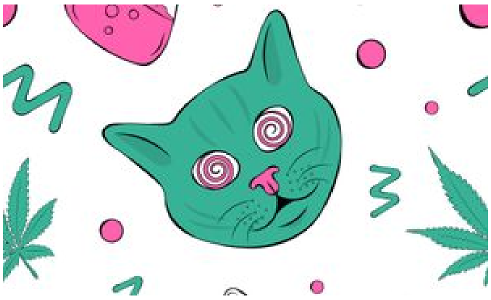

Two SEC Commissioners dissent from the Commission's settlement with Stoner Cats.

The SEC has charged, and accepted an offer of settlement, from Stoner Cats 2, LLC (SC2), for conducting an unregistered offering of crypto securities assets in the form of nonfungible tokens (NFTs) which raised approximately $8 million from investors to finance an animated web series called Stoner Cats (*In the Matter of Stoner Cats 2, LLC*, Release No. 33-11233, September 13, 3023).

Stoner Cats. According to the SEC press release, on July 27, 2021, SC2 "offered and sold to investors more than 10,000 NFTs for approximately $800 each," which sold out in 35 minutes. The SEC's order found that before and after the NFTs were sold, SC2's marketing campaign highlighted the specific benefits of ownership and that owners could resell their NFTs on the secondary market.

As part of the marketing campaign, SC2 emphasized its "expertise as Hollywood producers, its knowledge of crypto projects, and the well-known actors involved in the web series, leading investors to expect profits because a successful web series could cause the resale value of the Stoner Cats NFTs in the secondary market to rise." The order also found that SC2 "configured the Stoner Cats NFTs to provide SC2 a 2.5 percent royalty for each secondary market transaction" involving the NFTs, and SC2 "encouraged individuals to buy and sell the NFTs, leading purchasers to spend more than $20 million in at least 10,000 transactions."

Violations. According to the SEC's order, SC2 violated the Securities Act of 1933 by offering and selling the crypto asset NFTs to the public in an unregistered offering that was not exempt from registration.

Penalties. Without admitting or denying the SEC's findings, SC2 agreed to a cease-and-desist order and to pay a civil penalty of $1 million. The order also establishes a Fair Fund to return monies to injured investors, and SC2 agreed to "destroy all NFTs in its possession or control and publish notice of the order on its website and social media channels."

Dissent. For their part, SEC Commissioners Hester M. Peirce and Mark T. Uyeda, issued a statement dissenting from the Commissions second NFT settlement, explaining that "the application of the *Howey* investment contract analysis in the matter lacked any meaningful limiting principle and it carries implications for creators of all kinds." Rather than arbitrarily bringing enforcement actions against NFT projects, the Commissioners suggested that the SEC set forth some "clear guidelines for artists and other creators who want to experiment with NFTs as a way to support their creative efforts and build their fan communities."

The activity at issue, according to the Commissioners, represents activity they believe constitutes fan crowdfunding and they offered an observation that the NFTs "are not that different from Star Wars collectibles sold in the 1970s," when the toy company Kenner sold "Early Bird Certificate Packages," which were "redeemable for future Luke Skywalker, Princess Leia, and R2-D2 action figures and membership in the Star Wars fan club." The Commissioners then questioned whether those I.O.U. certificates, which could be re-sold, would constitute investment contracts.

The Commissions application of the securities laws in regard to the SC2 enforcement action makes little sense, according to the Commissioners, and it “discourages content creators from exploring ways to harness social networks to create and distribute content.” More generally, the Commissioners concluded that the decision contributes to the legal ambiguity that artists, writers, musicians, filmmakers, and others face when seeking to build a loyal and engaged following.

The release is No. 33-11233.

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